Micro-Economic Monitor

First Quarter 2002

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This document is also available on the Internet at http://strategis.ic.gc.ca/sc_ecnmy/mera/engdoc/04.html

Table of Contents

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Overview A

Domestic Scene

Real Economic Activity B
Income Side C
Labour Situation D
Sectoral Overview E
Productivity and Competitiveness F
International Accounts G
Price Movements H
Financial Variables I
Fiscal Track J

Overview

The Canadian economy posted solid growth in the first quarter...

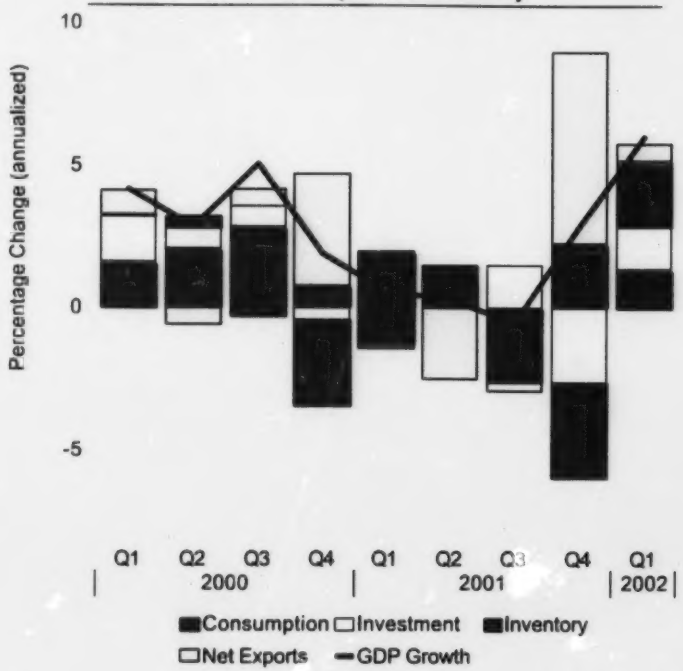
Real Gross Domestic Product (GDP) rose at an annualized rate of 6.0% in the first quarter of 2002, twice that of the previous quarter and the best performance since the fourth quarter of 1999.

Growth was fueled by less rapid inventory drawdowns, further increases in residential investment and a rebound in exports. Supported by rising disposable income and low interest rates, consumer spending grew further but at a slower pace. Business investment fell further, with another decline in non-residential construction.

As final domestic demand strengthened, imports registered their highest quarterly gain in two years. Net exports contributed less to growth than in the previous quarter.

Canada continued to outperform the United States (U.S.) in output and employment growth. However, the U.S. outperformed Canada in labour productivity growth.

Contributions to Quarterly Real GDP Growth* (Annualized)



*** For the purpose of simplification and given their relative stability over time, contributions from government expenditures and investment are not shown.**

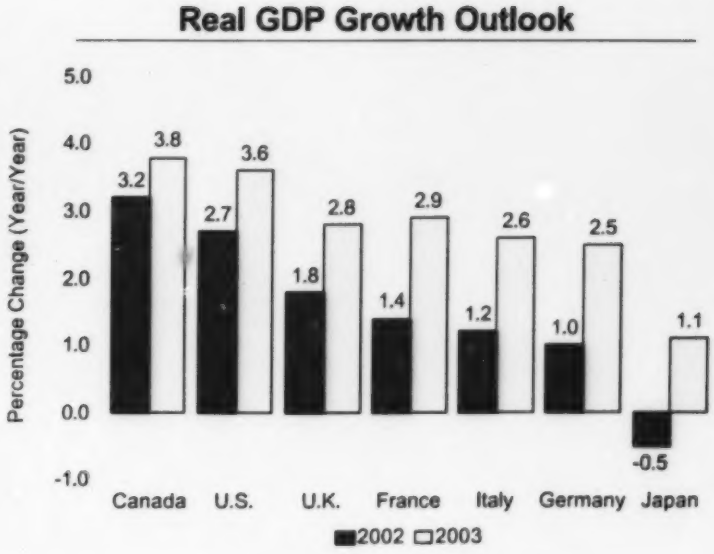
Source: Statistics Canada

...and is expected to lead the G-7 in 2002 and 2003

Recent developments in both Canada and the U.S. point to continued, albeit more moderate growth. Canada and the U.S. are expected to outperform other G-7 countries in 2002 and 2003.

With Canada's economic conditions and prospects improving substantially in recent months, the Bank of Canada has already started to make monetary conditions less stimulative. The Bank raised its target rate twice in April and in June, bringing the rate to 2.5% from a 40 year low of 2.0%. The U.S. Federal Reserve, for its part, has kept the Federal funds rate unchanged at 1.75%.

A widening spread between Canadian short-term interest rates and their U.S. counterparts has helped boost the Canadian dollar.



Source: U.K. Consensus Forecasts, June 2002

Domestic Scene

Real Economic Activity

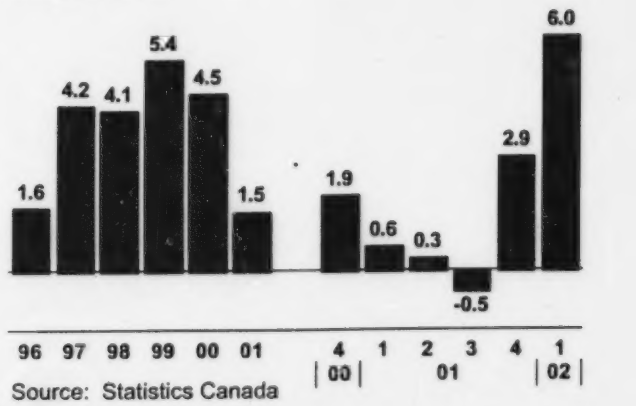
The economy strengthened in the first quarter...

Real GDP jumped at an annualized rate of 6.0% in the first quarter of 2002, twice that of the previous quarter and the best performance since the fourth quarter of 1999.

- **A buoyant housing market and strong increases of consumer spending on big ticket items drove final domestic demand up 3.5%.**

- **A slower pace of inventory liquidation and a larger trade surplus accounted for nearly half of real GDP growth.**

Real GDP Growth



Source: Statistics Canada

Recovery is also under way in the U.S. where real GDP rose by 5.6% in the first quarter of 2002, up from 1.7% in the previous quarter.

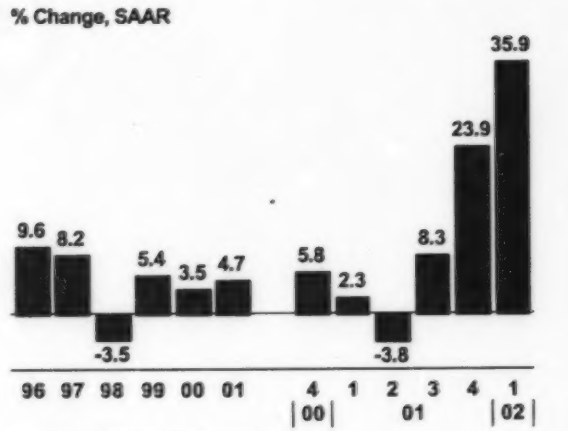
...driven by a red-hot housing market...

Real residential investment surged 36% in the first quarter, surpassing the record high level set in the first quarter of 1989.

- **A 49% gain in housing construction accounted for the lion's share of the overall increase in residential investment. Sales of existing homes and home renovations also posted two-digit growth rate over the quarter.**

Strong personal income growth, relatively low mortgage rates and high consumer confidence continued to fuel the housing market.

Real Residential Construction Growth



Source: Statistics Canada

...healthy consumer spending...

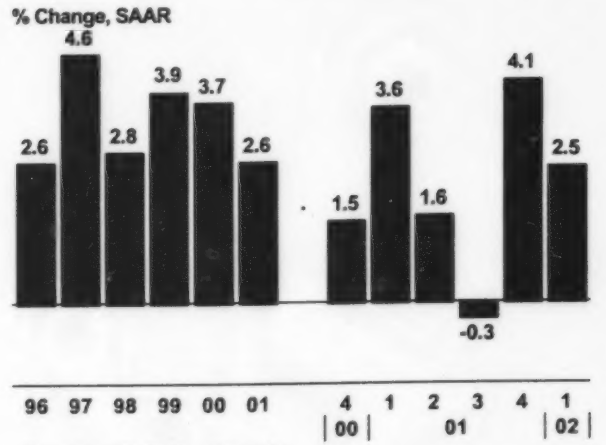
Consumer spending rose 2.5% in the first quarter, following a strong 4.1% increase in the previous quarter.

- **Higher demand for durable and semi-durable goods, notably for home furnishings and appliances, accounted for the bulk of this gain. Sales of new motor vehicles also continued to increase.**

- **Declines were reported in energy consumption and spending on services remained stable.**

Retail trade data indicated that sales continued to increase significantly in January but fell slightly in February and March as auto sales set back a little after posting huge gains from October 2001 to January 2002. This suggests a levelling off of consumption in the near term, but rising employment and income combined with historically high consumer confidence all bode well for healthy growth in consumption.

Real Consumer Expenditure Growth



Source: Statistics Canada

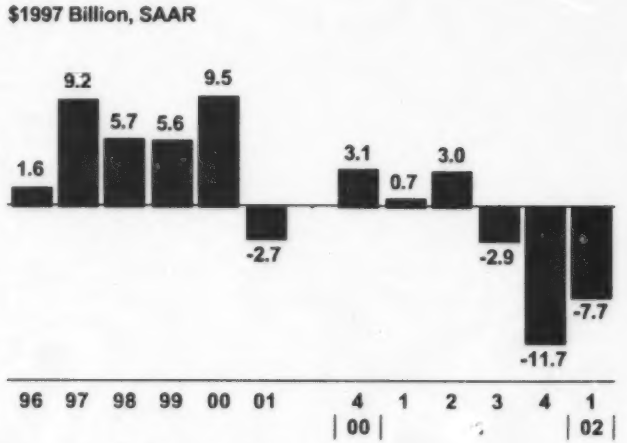
...and a slowdown in business inventories liquidation

Business continued to reduce inventories in the first quarter, but at half the pace of the previous quarter. This contributed 2.3 percentage points to real GDP growth.

- **Manufacturers, as well as wholesalers and retailers of new motor vehicles reduced their inventories by about $6.7 billion.**

- **The economy-wide inventory-to-sales ratio fell to an all-time low of 0.67.**

Non-farm Business Inventory Investment



Source: Statistics Canada

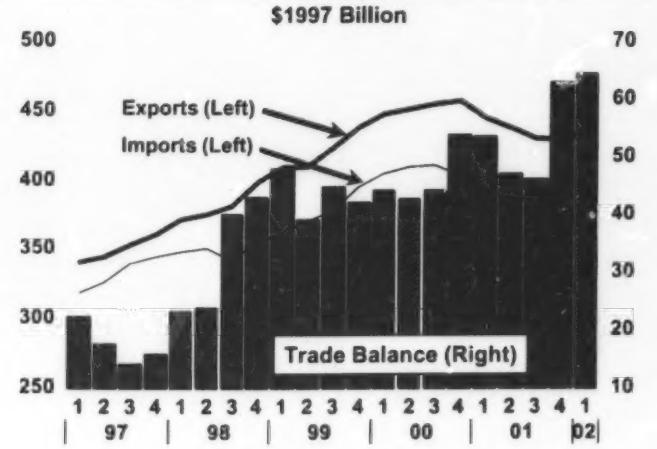
Both exports and imports reversed their downward trend...

Reflecting renewed strength in Canada and the U.S., exports and imports both rose for the first time in a year. The increase in the trade surplus contributed 0.6 percentage points to growth.

- **Export growth resumed in the first quarter, recording a healthy 5.9% gain. This ends a string of four consecutive quarterly declines, and represents the best showing in two years.**

- **Imports also increased significantly in the first quarter (+5.2%), the first quarterly gain since the third quarter of 2000.**

Real Exports and Imports of Goods & Services



Source: Statistics Canada

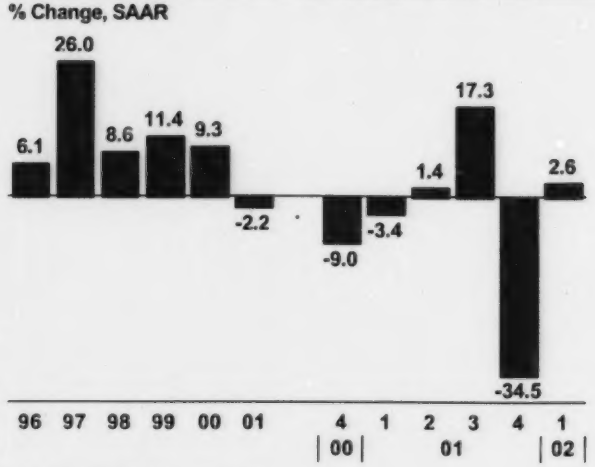
...and investment in Machinery and Equipment recovered slightly

Business investment in Machinery and Equipment (M&E) edged up 2.6% in the first quarter, recovering from a sharp 35% drop in the previous quarter.

- **Higher spending on transportation equipment, software and telecommunication equipment were partly offset by lower spending on machinery and computers.**

- **Notable increases in corporate profits in the first quarter may support further improvement in M&E investment.**

Real Machinery & Equipment Investment



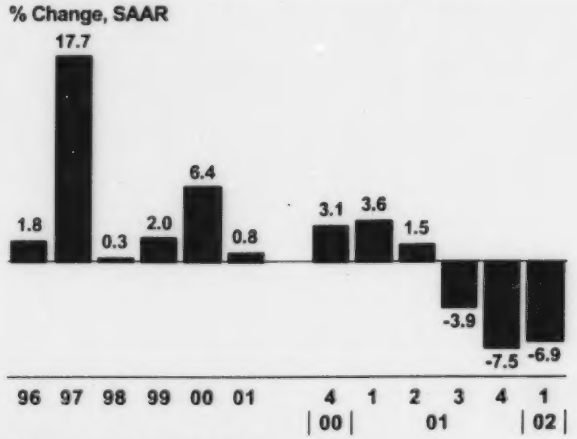
Source: Statistics Canada

But non-residential construction remained a source of weakness

Investment in non-residential structures fell 6.9% in the first quarter, recording a third consecutive quarterly decline.

- **Construction of engineering structures and non residential building weakened further.**

Real Non-residential Construction Growth



Source: Statistics Canada

Historical revisions increase estimates of Gross Domestic Product growth over the 1998-2001 period

Historical revisions to the National Economic and Financial Accounts had the following impacts:

- **Real GDP for 1998 was revised down (-0.1%), but up for 1999 (+0.2%), 2000 (+0.3%) and 2001 (+0.3%). As a result, average annual GDP growth over the 1998-2001 period is now 3.8%, 0.14 percentage point higher than the previous estimate.**

- **The 1998-2001 nominal annual growth of the following aggregates are now estimated at:**

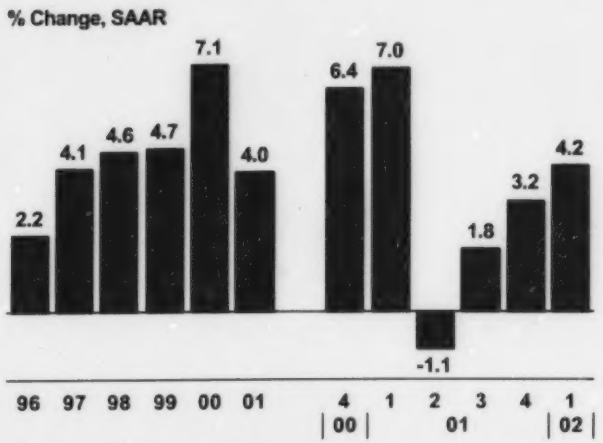
- Labour income:	6.2%, up from 5.6%
- Corporate profits:	11.1%, down from 11.8%
- Consumer spending:	5.3%, up from 5.1%
- Residential investment:	7.1%, up from 6.7%
- Non-residential investment:	2.0%, up from 1.5%
- Exports:	7.7%, up from 7.5%
- Imports:	4.9%, up from 4.7%

Domestic Scene

Income Side

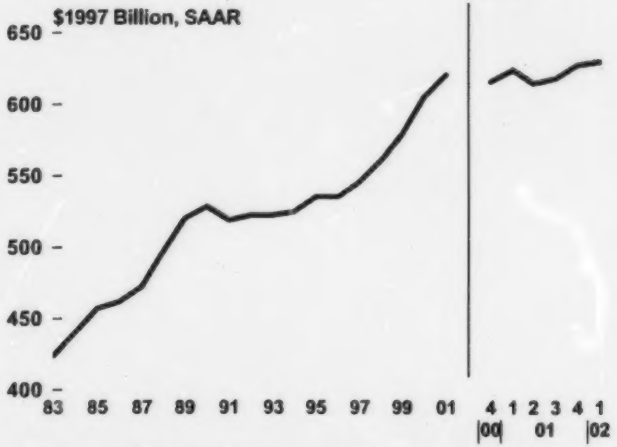
Personal disposable income rose further...

Growth in Personal Income



Source: Statistics Canada

Real Personal Disposable Income*



*Converted to real dollars using the chain price index for personal expenditure on goods and services.
Source: Statistics Canada and Industry Canada

Personal income increased by 4.2% in the first quarter of 2002, the third consecutive quarterly increase. Strong growth in labour income, government transfers and unincorporated businesses income more than offset a decline in investment income.

- Low interest rates contributed to the decrease of investment income.

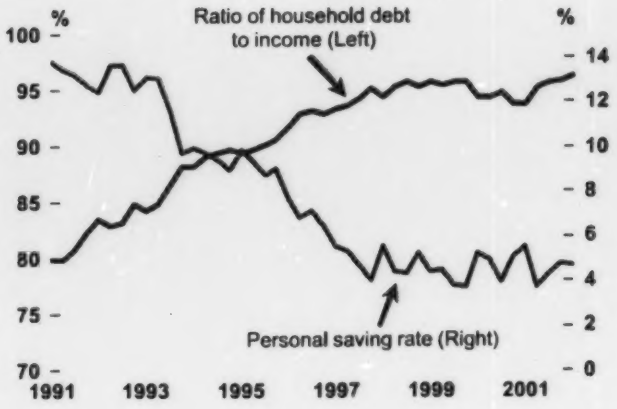
Real personal disposable income growth moderated to 1.8% from 6.4% in the previous quarter.

...while the saving rate was steady

Expenditures on consumer goods and services slightly outpaced disposable income growth, and the personal savings rate edged down to 4.7% from 4.8% in the previous quarter.

The household debt-to-income ratio increased 0.4 percentage point to 96.3%, as consumer and mortgage debt levels increased faster than disposable income.

Personal Debt and Savings Rate



Source: Statistics Canada

C-2

Corporate profits rebounded

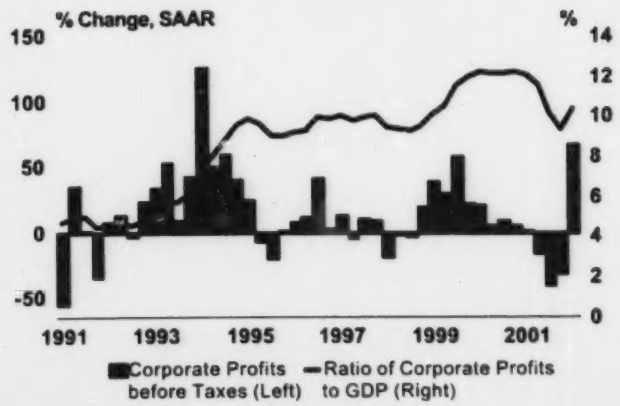
Corporate profits jumped 13.8% from the previous quarter, recovering almost half the ground lost since the first quarter of 2001.

- **Profit gains were widespread, with particularly strong performance in the manufacturing and construction sectors.**

- **The profit gains came partly from the clearance of inventories at higher prices.**

The profit share of GDP increased to 10.4%, the first quarterly increase since the fourth quarter of 2000 when it peaked at 12.2%.

Corporate Profits



Source: Statistics Canada

Domestic Scene

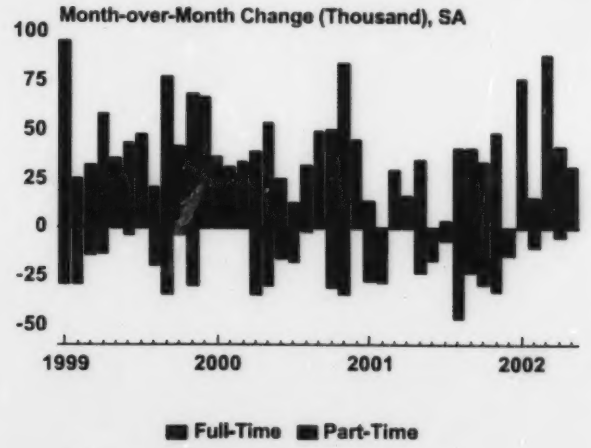
Labour Situation

Employment posted its fifth consecutive monthly increase in May

In May, 31 000 jobs were created, bringing total job gains to 237 000 or 1.6% in the first five months of 2002. This is the largest five month gain since 1994.

Most of the jobs created so far this year are full-time jobs (+139 000). This is in contrast to last year when 26 000 full-time jobs were lost, while part-time employment increased by 39 000.

Employment Growth



Source: Statistics Canada

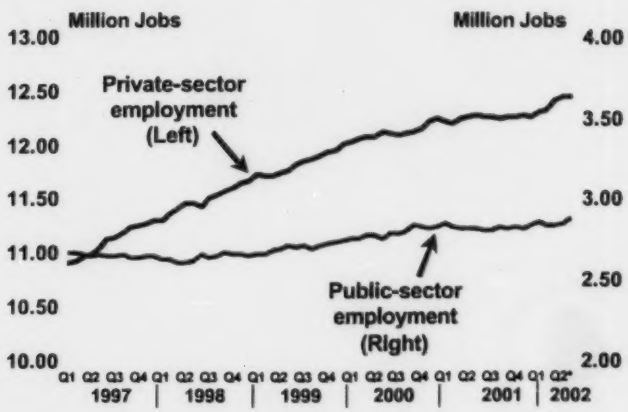
In May, non-farm employment rose by only 41 000 in the U.S. In contrast to Canada, employment conditions have been weak in the U.S., with 142 000 jobs being lost so far this year. The unemployment rate edged down 0.2 percentage point to 5.8%.

More public than private sector jobs were created in May for the first time since December.

In May, public sector employment (+30 000) accounted for all of the growth in paid employment, largely due to more Educational Services jobs. This is the first time since December that more public than private jobs were created. The private sector (+148 000) has created most of the jobs since the beginning of the year.

In the first five months of 2002, paid employment increased by 191 000 jobs, compared to 46 000 in self-employment. Paid employment increased by 22 000 in May, self-employment, by 9 000.

Employment: Private vs. Public



*Data for 2002Q2 includes April and May only.

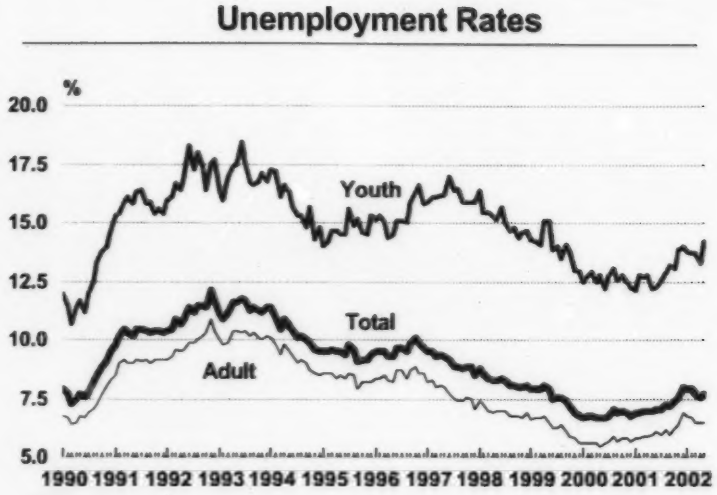
Source: Statistics Canada

Unemployment declines little as more Canadians enter job markets

Despite strong employment growth, the unemployment rate has fallen only marginally since its December peak of 8.0%. Better economic conditions have encouraged more Canadians to enter the labour force.

The unemployment rate rose marginally to 7.7% in May, largely due to a rise in the unemployment rate for youth (+0.9 of a percentage point to 14.2%). Despite recent job gains by youth, their unemployment rate is still 2.0 percentage points higher than a year ago. Job creation for youth has fallen short of the increase in their numbers in the labour force.

Adult unemployment has declined slightly in the last five months, with job gains for both adult men and women.



Source: Statistics Canada

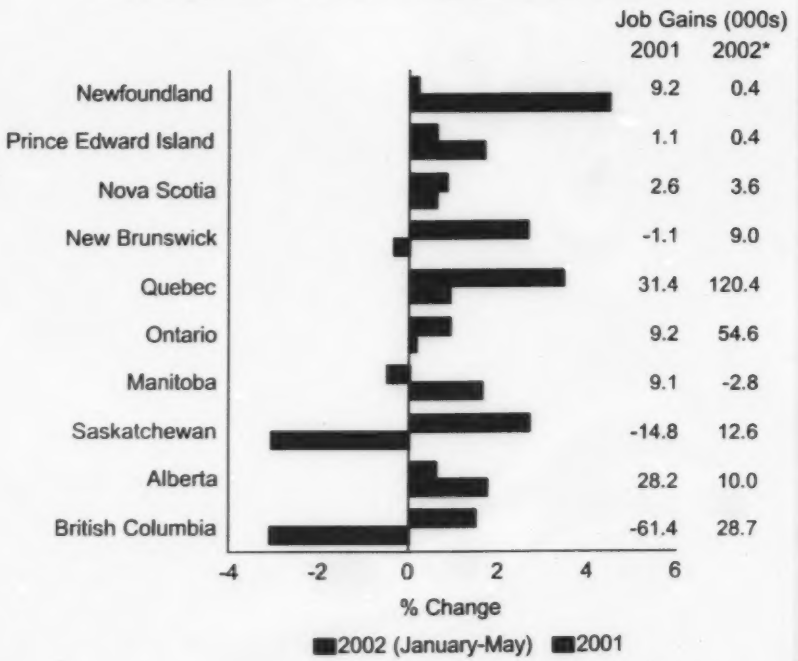
Job gains in May are concentrated in Quebec, Ontario and British Columbia

So far in 2002, Quebec has created the most jobs, accounting for more than half of the job gains in Canada. Most of the job gains in Quebec have been in Services. Ontario accounted for almost a quarter of the overall job gains in Canada, largely in the Manufacturing sector.

In Atlantic Canada, the largest job gains this year have been posted by New Brunswick and Nova Scotia.

Manitoba is the only western province posting job losses (-3 000) so far this year. Saskatchewan's employment gains (12 600) follow job losses in 2001. Alberta has seen an increase of 10 000 jobs so far in 2002. In B.C., despite the net job gains of 29 000 so far this year, employment is still 26 000 below its level of May 2001.

Employment Growth by Province



*Figures for 2002 are year-to-date (January-May)
Source: Statistics Canada

The unemployment rate has fallen in several provinces, particularly in the Atlantic region and Quebec

The unemployment rate has fallen in all provinces since December, except in Manitoba (+0.8 point to 5.4%), Alberta (+0.8 point to 5.9%) and Ontario (+0.1 point to 7.0%).

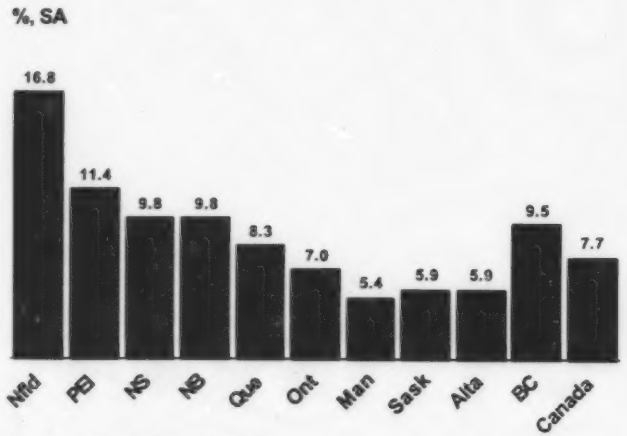
In Atlantic Canada, the most notable decreases are in New Brunswick and P.E.I.

Quebec's unemployment rate, at 8.3% in May is 1.4 percentage points lower than last December.

The jobless rate has fallen in Saskatchewan as employment has strengthened after a lacklustre performance in 2001.

In May, the unemployment rate in B.C. increased by 0.8 point to 9.5%. This is down 0.2 percentage point from December, but up 2.6 percentage points from May 2001.

Unemployment Rates: May 2002



Source: Statistics Canada

Domestic Scene

Sectoral Overview

Output rises in most industries in the first quarter

Output in the Goods-producing industries surged at an annualized rate of 8.5% in the first quarter of 2002, ending a string of five consecutive quarterly declines.

- **A rebound in Manufacturing activity accounted for about two thirds of the overall increase, with 19 of 21 major groups reporting gains. Computer & electronic equipment, Wood products, and Furniture recorded the largest increases.**

- **Residential construction surged 33.1%, its largest gain since the 1980's housing boom, contributing to a healthy gain in the Construction industry.**

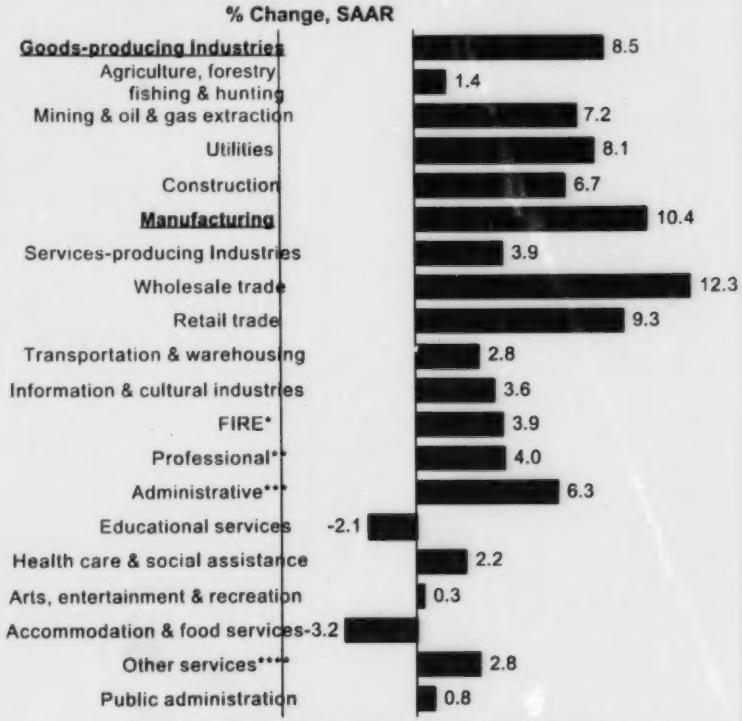
Activity in the Services-producing industries was up 3.9% in the first quarter.

- **Wholesale and Retail trade recorded the largest gains, benefiting from higher sales of furnitures and motor vehicles and parts.**

- **Declines were reported only in Education services as a result of a strike by Alberta teachers, and Accommodation and Food services.**

Overall, Gross Domestic Product at basic prices rose 5.3% in the quarter, reflecting sharp increases in January and February as output showed little growth in March.

Real GDP Growth by Industry: 2002Q1



* Includes Finance & insurance, real estate & renting & leasing & management of companies & enterprises
** Includes Professional, scientific & technical services
*** Includes Administrative & support, waste management & remediation services
**** except public administration

Source: Statistics Canada

E-1

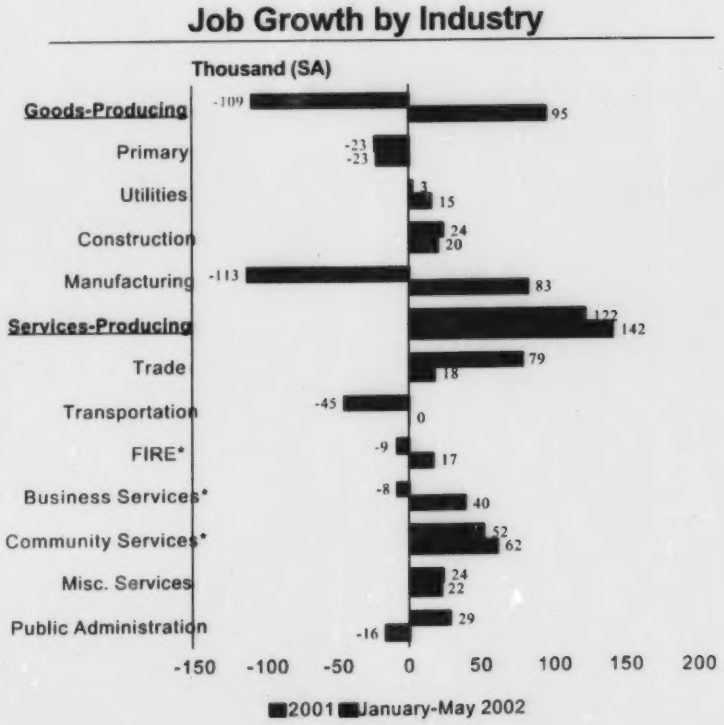
Manufacturing sector has accounted for the largest job gains so far in 2002...

Employment in the Goods sector is up 95 000 over the first five months of the year, recouping most of the losses of 2001.

- **Gains were largely concentrated in Manufacturing (+83 000). Factory employment is still, however, some 30 000 below its peak of December 2000. The Primary sector is the only one posting job losses this year.**

In Services industries, 142 000 jobs have been created so far this year, up from 122 000 jobs in 2001.

- **While gains in 2001 were concentrated in Service Trade, Community Services and Public Administration, they have been broadly based this year. Public Administration is the only sector to post job losses this year.**

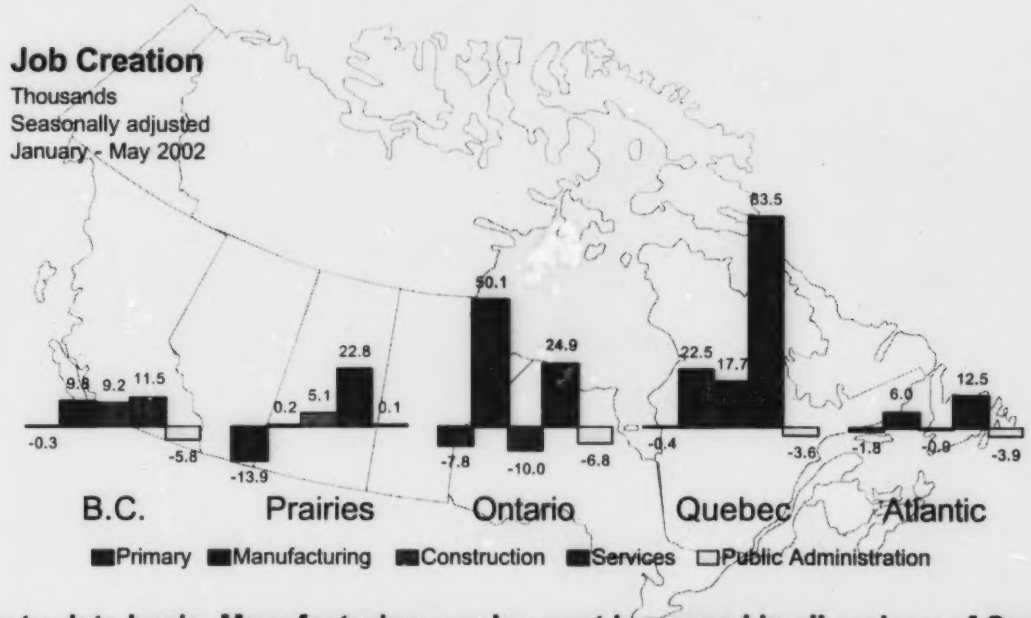


*FIRE: Finance, Insurance, Real Estate and Leasing
Business Services: Management, Administrative, Professional, Scientific & Technical Services
Community Services: Educational Services, Health & Social Assistance.

Source: Statistics Canada

E-2

...and was concentrated in Ontario and Quebec



On a year-to-date basis, Manufacturing employment increased in all regions of Canada. The highest gains were in Ontario, Quebec. Jobs in the Primary sector fell in all regions. The largest loss was posted by Natural Resources in Alberta where the decline in energy prices through 2001 has slowed activities in the oil & gas sector.

Employment in Services increased in every region of the country. Gains in Construction employment have taken place mainly in Quebec and B.C., while the number of jobs in Public Administration fell in all regions.

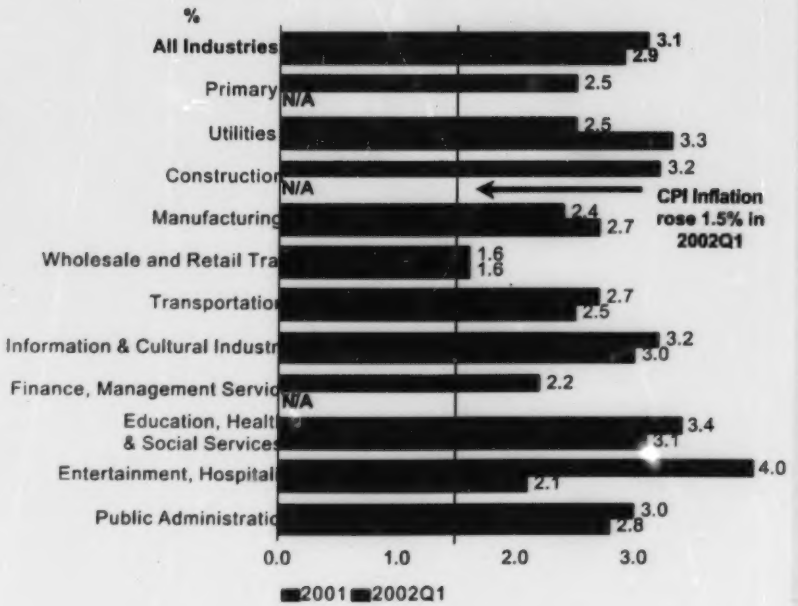
Wage settlements eased in the first quarter but exceeded inflation

Wage settlements averaged 2.9% in the first quarter of 2002, slightly below the pace set in 2001, but almost twice the increase in the Consumer Price Index (CPI). These results are in line with a solid performance of the Canadian economy during the quarter.

Wage increases were above inflation in all industries.

Public-sector wage settlements (+3.1%) have continued to be above those in the Private sector (+2.0%).

Wage Settlements by Industry



Effective average annual adjustments in base wage rates from major collective bargaining agreements.

Source: Human Resources Development Canada

E-4

Capacity utilization increases in the first quarter

Capacity utilization rose by 1.3 percentage points to 81.7% in the first quarter of 2002. This halts a string of six consecutive declines. However, the capacity rate was still below its 10-year average and much below the recent 86.3% peak of 2000.

In manufacturing, production rose sharply to meet rising demand in the first quarter but the capacity use in this sector was still well below the rates posted in the beginning of 2000 and below the 10-year average.

- **Higher capacity rates were posted in 17 of 21 industry groups, led by the Transportation Equipment sector.**

- **Computer & Electronic products recorded the first capacity use increase since the third quarter of 2000 but it remains 15 percentage points below the 10-year average.**

Capacity use rate in Electric Power rose because of increased demand by manufacturers. Strong residential construction pushed up the rate in Construction to over 90%, significantly above its 10-year average. In Forestry & Logging the rate dropped to 70.0%, the lowest on record.

Capacity Utilization: Non-farm Goods-producing Industries

	Level (%) 2002Q1	Change (% points) Q/Q	Change (% points) Y/Y	10-year Average
Total industrial	81.7	1.3	-2.3	82.3
Forestry & logging	70.0	-5.8	-18.4	82.4
Mining & oil & gas extraction	74.2	0.8	-4.2	79.2
Electric power *	87.7	1.5	-1.3	83.4
Construction	90.7	0.9	0.4	82.8
Total Manufacturing	80.6	1.8	-2.2	82.8
Food	82.1	-0.1	0.9	80.6
Beverage & tobacco products	74.3	-2.0	-3.8	80.2
Textiles	77.9	0.6	-3.5	80.6
Textile mills	79.2	0.1	-3.1	83.1
Textile product mills	76.2	1.2	-4.0	79.5
Clothing	81.6	3.8	-4.8	82.4
Leather & allied products	70.2	1.1	-6.0	74.3
Wood products	85.5	4.6	2.8	86.0
Paper	86.6	-1.7	-4.7	90.0
Printing & related support activities	72.1	-0.3	-8.5	77.9
Petroleum and coal products	95.9	0.1	-0.9	91.6
Chemical	78.4	3.0	-4.2	82.1
Plastic & rubber products	83.5	2.9	2.7	83.2
Non-metallic mineral products	80.0	3.7	1.4	76.9
Primary metal	87.0	1.1	1.3	89.5
Fabricated metal products	80.0	0.9	-2.2	79.4
Machinery	77.9	0.3	-2.3	79.8
Computer & electronic products	65.7	4.7	-15.9	79.9
Electrical equipment	66.9	0.4	-15.6	83.0
Transportation equipment	88.1	3.3	5.8	84.1
Furniture & related products	74.8	3.2	-12.1	80.1
Miscellaneous manufacturing	77.9	0.3	-5.3	81.6

*Electric power generation, transmission & distribution
Source: Statistics Canada

Domestic Scene

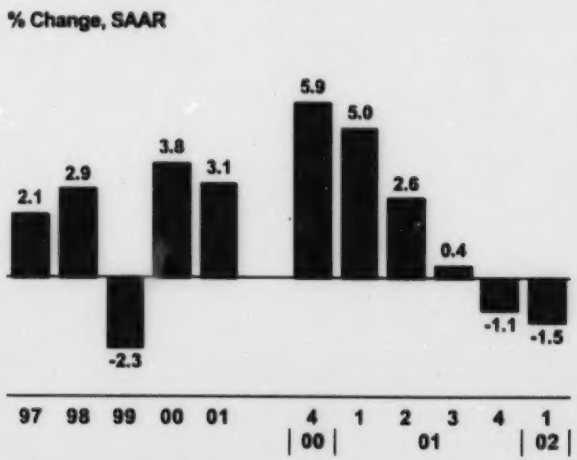
Productivity & Competitiveness

Unit labour costs fall in the first quarter...

Unit labour costs in the business sector were down 1.5% (annual rate) in the first quarter following a 1.1% decline in the previous quarter.

- **Labour productivity recorded a healthy 4.1% increase, up from 3.0% in the first quarter. This is the best performance since the second half of 1999. Productivity growth outpaced the rise of 2.8% in wages and salaries.**

Growth in Unit Labour Costs*



* For the business sector.
Source: Statistics Canada

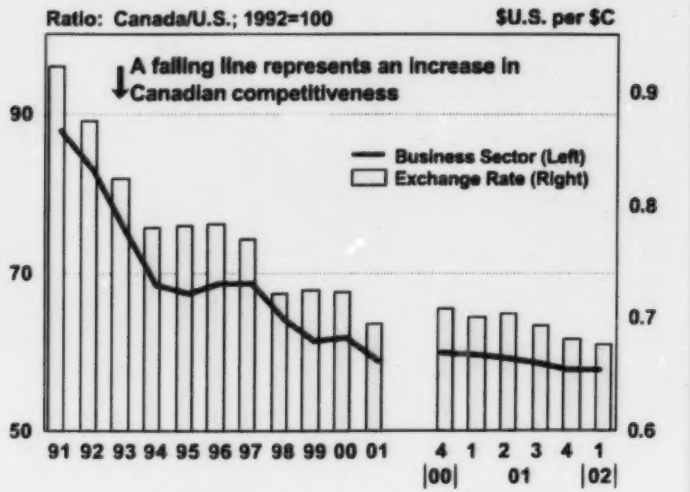
... helping firms to maintain their competitiveness

The competitive position of Canadian firms was virtually unchanged relative to the U.S. in the first quarter of 2002. On a same currency basis, unit labour costs fell 4.9% in Canada, in comparison to a 5.0% decline in the U.S.

- **Labour productivity in the business sector was up 8.2% in the first quarter in the U.S., a pace twice that recorded in Canada.**

- **However, wages increased at a slightly slower pace in Canada and the Canadian dollar weakened, falling to an average of US62.7¢ in the first quarter from US63.1¢ in the previous quarter.**

Unit Labour Cost Comparison ($US)



Source: Industry Canada calculations based on data from the U.S. Bureau of Labor Statistics and Statistics Canada

Domestic Scene

International Accounts

Current account surplus increased in the first quarter...

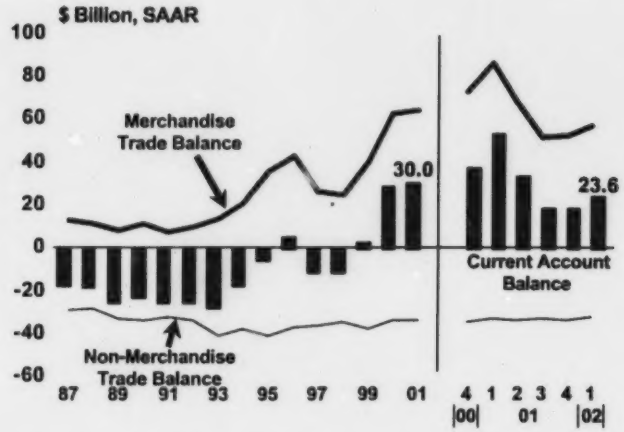
Canada's current account surplus rose by $1.5 billion to $5.9 billion ($23.6 billion annualized) in the first quarter, largely reflecting an improvement in the merchandise trade surplus.

On the capital and financial account, Canadians invested $22.6 billion in foreign countries in the first quarter, while foreigners invested $27.1 billion in Canada.

- **At $7.2 billion, Canadian <u>direct</u> investment abroad was similar to the level in the fourth quarter. Most investments went to existing affiliates.**

- **Foreign acquisitions, primarily in the energy and mining sectors amounted to $10.6 billion, accounting for most of the $17.1 billion of foreign direct investment into Canada. This was the largest direct investment in the past five quarters.**

Current Account & Trade Balances



The merchandise trade balance represents net exports of goods.

The non-merchandise trade balance represents net exports of services plus net receipts of investment income and transfers.

Source: Statistics Canada

...helped by an upswing in the merchandise trade surplus...

The merchandise trade surplus increased by $1.2 billion to $14.2 billion ($56.6 billion annualized) in the first quarter. It was the first quarterly increase in a year.

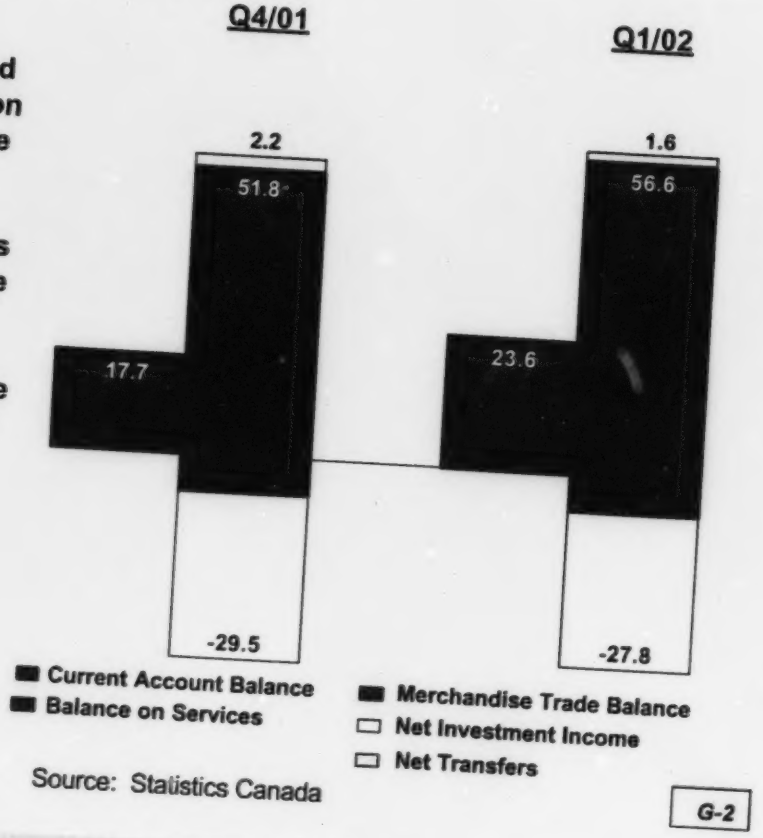
- The increase in Canada's trade surplus with the U.S. accounted for most of the improvement in total trade surplus.

At $1.7 billion ($6.8 billion annualized), the deficit on services remained the same as in the previous quarter.

The deficit on investment income decreased, largely due to higher returns on Canadian operations abroad.

Main Components of the Current Account

$ Billion, SAAR



Source: Statistics Canada

G-2

...due to a stronger recovery in exports...

Merchandise exports, rose 3.1% in the first quarter, following three consecutive quarterly declines. On a year-over-year basis, however, exports were down by almost 10%.

- Energy exports led the way, rising $1.4 billion (+15.9%). Exports of Industrial Goods, Automotive Products and Consumer Goods also contributed to the overall quarterly growth of exports. Over the last year, however, exports of Energy Products decreased by almost half.
- Exports of Machinery & Equipment were virtually unchanged in the quarter, but down 11.1% on a year-over-year basis.
- Exports of Agriculture & Fishing Products (-1.0%) was the only group to post a decline in the first quarter.

Merchandise Exports, 2002Q1

	$ Billion	% Change Jan-Mar/01 - Jan-Mar/02
Total	99.6	-9.9
By Trade Partner		
U.S.	84.7	-10.4
Japan	2.1	-18.9
E.U.	5.6	-5.0
All Others	7.3	-4.7
By Principal Commodity		
Agricultural & Fishing Products	7.8	5.3
Energy Products	10.5	-45.8
Forestry Products	9.3	-6.6
Industrial Goods & Materials	16.8	0.9
Machinery & Equipment	23.8	-11.1
Automotive Products	23.4	4.0
Other Consumer Goods	4.3	7.9

Source: Statistics Canada

...than in imports.

Merchandise imports rose 2.1% in the first quarter of 2002, breaking a string of three consecutive quarterly declines.

- **This was mainly due to an increase of $0.8 billion for Automotive Products and $0.6 billion for Industrial Goods. The only group to post a decline was Machinery & Equipment (-0.4%).**

On a year-over-year basis, however, imports were down 7.3%.

- **Agriculture, fisheries, automotive and consumer products were up, but other products were down.**

Merchandise Imports, 2002Q1

	$ Billion	% Change Jan-Mar/01 - Jan-Mar/02
Total	85.6	-4.3
By Trade Partner		
U.S.	62.2	-4.6
Japan	2.7	3.3
E.U.	8.1	-8.5
All Others	12.7	-1.2
By Principal Commodity		
Agricultural & Fishing Products	5.4	8.9
Energy Products	3.5	-31.8
Forestry Products	0.7	-1.7
Industrial Goods & Materials	16.9	-5.2
Machinery & Equipment	25.7	-14.7
Automotive Products	19.1	12.2
Other Consumer Goods	11.1	5.3

Domestic Scene

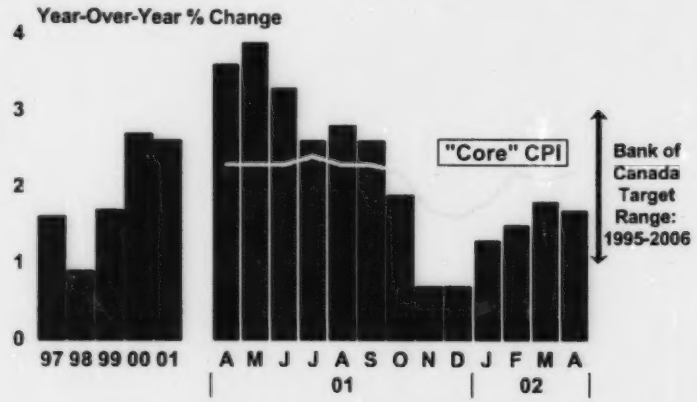
Price Movements

Inflation remains moderate despite recent increases...

Year-over-year Consumer Price Index (CPI) inflation rose steadily in the first three months of 2002. It was up from an average of 1.1% in the fourth quarter of 2001 to 1.5% in the first quarter of this year and 1.7% in April. Increases in transportation, shelter, food, and tobacco prices are the main drivers of the uptick in the CPI inflation.

"Core" inflation – which excludes the most volatile components of the overall CPI and indirect taxes and is the target for monetary policy – edged up 0.1 percentage point in April to 2.2%, near the midpoint of the official 1-3% target range.

Consumer Price Index



In May 2001, the Bank of Canada and the Finance Department announced the renewal of the inflation target for monetary policy until 2006. The Bank also refined its measure for the underlying trend in inflation as measured by "core" inflation.
The "Core" CPI excludes prices for fruit, vegetables, gasoline, fuel oil, natural gas, mortgage interest, inter-city transportation and tobacco products as well as indirect taxes.

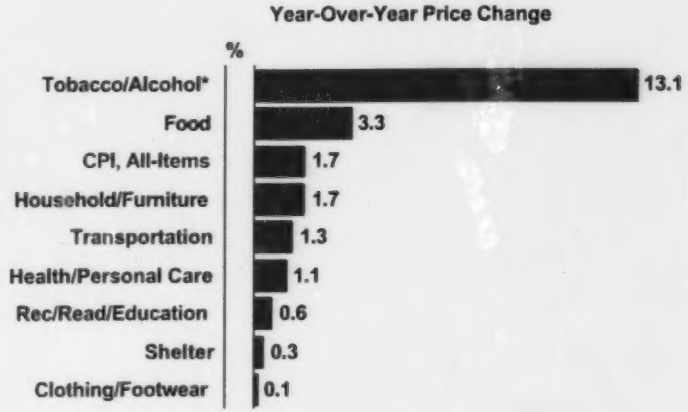
Source: Statistics Canada & Bank of Canada

...caused by higher costs of transportation, food and tobacco products

The year-over-year inflation was 1.7% in April, down from 1.8% in March but up from a low of 0.7% in the last two months of 2001.

- **The slowdown in inflation in April was mainly due to a smaller year-over-year rise in shelter cost.**
- **On a monthly basis, however, transportation, food and shelter cost have been increasing over the last four months, putting upward pressure on overall prices. In addition, tobacco prices are up markedly from last October as a result of federal and provincial tax increases.**
- **Excluding energy and food prices, consumer price inflation has trended up from a recent low of 1.2% in December to 1.9% in April.**

Components of CPI: April 2002



* Increases in sales taxes on cigarettes in six provinces in March and April 2001, on top of the introduction of the federal tax last November, pushed the Tobacco & Alcohol price index higher. As a result of these increases, the rise in the index has averaged 13.5% since November.

Source: Statistics Canada

Commodity prices are trending up in response to rising demand

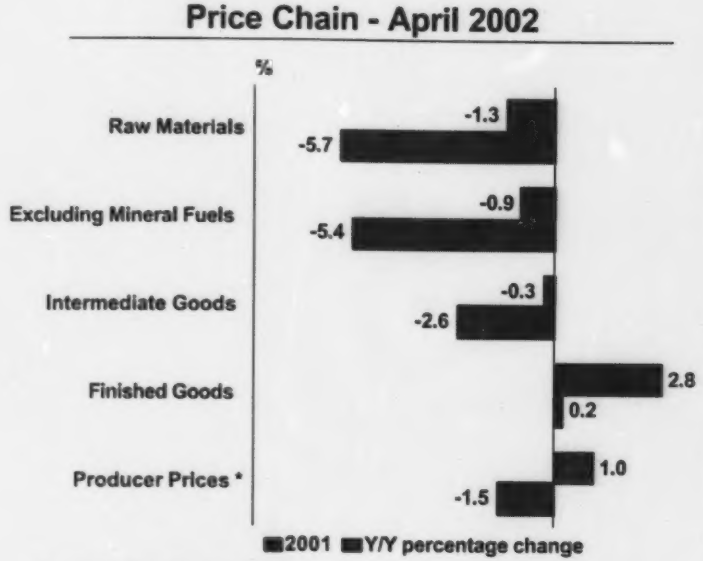
Industrial product prices – those received by producers at the factory gate – were down 1.5% in April on a year-over-year basis, the seventh consecutive month of decline. However, producer prices were up 1.9% from December, when both finished and intermediate prices bottomed out.

- **Compared to last year, petroleum & coal and pulp & paper product prices were sharply lower.**

- **Since December, only pulp & paper and rubber, leather & plastic fabric products were down, while petroleum & coal product prices were up 13% and motor vehicles were up 1.2%.**

The cost of raw materials fell for the ninth straight month in April, down 5.7%.

- **This was the smallest drop in eight months as raw materials have also been rising since December, driven mainly by rising mineral fuels and non-ferrous metal prices.**



Source: Statistics Canada

H-3

Domestic Scene

Financial Variables

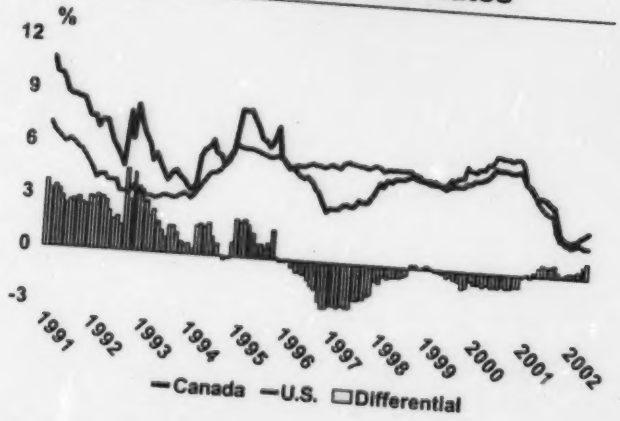
The Bank of Canada raises its policy rate while the Federal Reserve keeps rates at 40-year lows

The Bank of Canada increased its policy target rate by 25 basis points (bps) in April and again in June to 2.5% amid improving conditions and prospects in Canada and elsewhere. Most analysts expect the Bank of Canada to raise its policy rate further on July 16, the next policy announcement date.

In the United States, the Federal Reserve has kept its Federal Funds rate at 1.75%. Most analysts expect the Federal Reserve to stay on the sideline in the near-term before starting to raise interest rates.

In the money market, the Canadian 90-day commercial paper rate has increased from 2.0% in mid-January 2002 to 2.7% on May 29, 91 bps above the U.S. rate.

Short-Term Interest Rates



Last data point plotted: May 29, 2002

Source: Bank of Canada, 90-day Commercial Paper, last Wednesday in the month

Long-term bond yields retreat as investors shift funds to secure assets

North American long-term interest rates have fallen in recent months.

Among the factors contributing to this development:

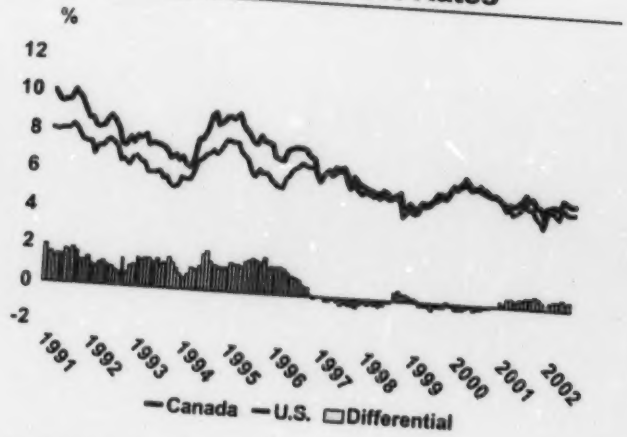
- **Investors now expect more moderate growth in the U.S. and, therefore, see less likelihood of early Federal Reserve intervention to raise interest rates; and**

- **Concern about corporate accounting practices caused investors to shift funds away from equity markets.**

Since its recent peak in late March, the Canadian 10-year bond yield has fallen 30 bps to 5.5% on June 6, while the U.S. 10-year bond yield has fallen 40 bps to 5.0%.

This left the Canada-U.S. long-term rate spread at 47 bps on June 6 compared to 44 bps at the end of March.

Long-Term Interest Rates



Last data point plotted: June 6 2002

Source: Bank of Canada, 10-year Government bond, last Wednesday in the month

The Canadian dollar recovers

The Canadian dollar climbed from a historical low of US62.0¢ in mid-January to a 10-month high of US65.5¢ on June 3 before retreating somewhat to close at US64.7¢ on June 14th.

- **Canada's better economic performance relative to the U.S., a rising spread between Canadian and U.S. interest rates and a recovery in commodity prices have helped bolster the Canadian dollar.**

Both the U.S. dollar and the Canadian dollar have weakened against the Euro and the Yen in recent months.

Canada-U.S. Exchange Rate

Last data point plotted: June 7, 2002

Source: Bank of Canada

Stock indices remain low

Equity markets have posted a lackluster performance in recent weeks, reflecting concern about corporate accounting practices and an uncertain profit outlook, in particular in the technology sector.

- **On June 10, the S&P/TSX index was down 6% from March's high while the U.S. S&P 500 index was down 12%.**

Stock Market Indices

Last data point plotted: June 10, 2002

* On May 1st, Canada's main equity index was renamed the Standard & Poor/Toronto Stock Exchange index (S&P/TSX). The composition of the index has not been changed to this date.

Source: Statistics Canada

Domestic Scene

Fiscal Track

Fifth consecutive federal surplus expected in 2001-02

For the 2000-01 fiscal year, the federal government recorded a budgetary surplus of $17.1 billion.

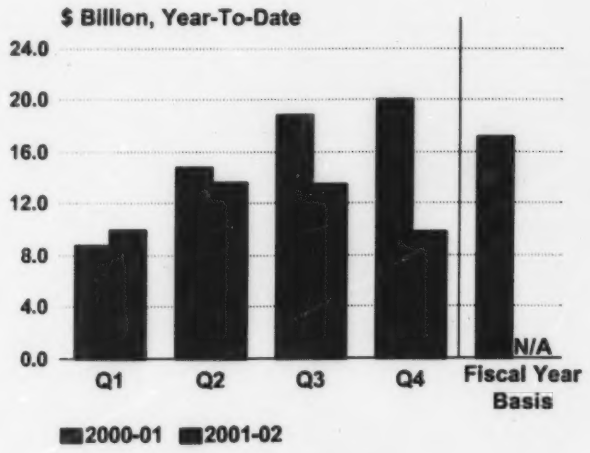
- **More than $35 billion of the public debt has been retired over the past four years. Net federal public debt is now 52% of GDP, down from a peak of 71% in 1995-96.**

Before end-of-year adjustments, the federal budgetary surplus is $9.8 billion in fiscal year 2001-02, following a surplus of $20.1 billion reported for the same period last year. In a recent economic statement to the Finance Committee meeting, the Minister of Finance said that "after year-end adjustments, which are still to come, we can reasonably expect a surplus of around $6 billion for 2001-2002". This is larger than expected in the December budget and will be used to further pay down the debt.

- **The lower surplus in 2001-02 reflects the ongoing impact of tax cuts and spending initiatives in the past few budgets as well as the general slowdown of the economy in 2001.**

On the provincial side, Atlantic provinces (except New Brunswick) and B.C. are still expected to record budgetary deficits in 2001-02, while the other provinces and territories (except Yukon) should have balanced budgets or surpluses.

Federal Budgetary Balance



Source: Department of Finance

For Further Information

We welcome your questions, comments and suggestions? You can reach us by ...

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The *Micro-Economic Monitor* is prepared on a quarterly basis by the Micro-Economic Policy Branch of Industry Canada. The Monitor provides a quick and easy-to-read update on Canada's economic performance. It also provides topical in-depth reports on current economic issues from a micro-economic perspective. This report uses data available as of June 11, 2002.

The current analysis update was prepared by Marianne Blais, Stéphane Crépeau, Anik Dufour, Miodrag Jovanovic, Joseph Macaluso and Patrick Taylor, under the direction of Hossein Rostami. Translation has been provided by Lucie Larocque, and Sue Hopf is responsible for administrative support.

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